Southwest Airlines: a model of superb management

Timing the stock market

Anglo American Corporation: South Africa after apartheid

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September 16, 1991 Four Dollars

Forbes

Hell no– we won't pay!

Why consumers are no longer faithful to their favorite brands

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The name brands are getting a little expensive. 114

Is this a mutual fund company? Or a bank? 38

How to run an airline. 48

ON THE COVER

Hell No—We Won't Pay 114
By Gretchen Morgenson
Could the glory days for packaged-goods marketers be over?

Southwest Airlines 48
By Subrata N. Chakravarty
If you want to see what great management looks like, look at this firm.

Anglo American Corp. 130
By Peter Fuhrman
Horizons are opening in South Africa and it stands to benefit mightily.

Timing The Market 154
By A. Gary Shilling
Better to sell too soon than overstay and risk a crash.

COMPANIES/INDUSTRIES

General Electric 41
By Howard Banks
The jet engine division is in a great power position.

Archer Daniels Midland 42
By Marcia Berss
How to get rich off tax breaks and congressional mandates.

Housing 93
By William Tucker
Don't count on builders to pull us out of this recession.

Giddings & Lewis 98
By Tatiana Pouschine
The toolmaker with the big R&D.

Salomon Inc. 113
By Richard L. Stern and Laura Jereski
How far did the ripples extend when Salomon fixed the note market?

Amerada Hess 127
By Howard Rudnitsky
Leon Hess stages a comeback.

Up & Comers: Stoneridge Resources 142
By Seth Lubove
Randy Samelson's ideas were fine but their execution was terrible.

Up & Comers: Helen Of Troy Corp. 144
By Claire Poole
A little company latched on to a very big name.

USX 166
By James R. Norman
Buying Marathon wasn't such a bad idea after all.

INTERNATIONAL

German Fashion 64
By Richard C. Morais
Guess where some of the smartest clothing is coming from these days?

Carlos Slim Helú 68
By Claire Poole
Meet Mexico's quiet wheeler-dealer.

LVMH 74
By Zina Sawaya and Phyllis Berman
Intrigue at the champagne-perfume-handbag house.

Mikimoto 88
By Hiroko Katayama
Yes, even Japanese firms can become stuffy and complacent.

Siberia: Hot Spot For Investors 96
By Vladimir Kvint
The Soviet breakup presents great opportunities for investors.

Turkey 171
By Roula Khalaf
It finds a promising market in republics next door.

MONEY & INVESTING

Money Men: Julian H. Robertson Jr. 78
By Frederick E. Rowe Jr.
His methods defy description but he's the hottest money manager.

Money Men: Managing Tax-Frees 120
By Katarzyna Wandycz
Heavy trading hasn't hurt fund manager Kenneth McAlley.

Charles Givens 174
By Mary Beth Grover
He has something to teach us: There's no such thing as bad publicity.

The Funds: Counsellors Tandem 198
By Suzanne L. Oliver
Why is it a disappointment?

The African empire builder smiles again.
130

Better to dismount the bull early than to be thrown.
154

The Funds:
Mutual Benefit Fund 199
By Seth Lubove
One of the worst-selling funds is one of the best performers.

The Forbes Index 36
The Forbes/Barra
Wall Street Review 195
Fixed Income Review 196

Streetwalker 208
The Dow after the coup; La Petite Academy; electric utilities; oil stocks; Carter-Wallace.

LAW AND ISSUES

Numbers Game:
McDonald's 44
By Dana Wechsler Linden
For a mature company, it sure is thirsty for cash.

Exodus 56
By James Cook
What happens when business leaves the cities for small-town America?

Think Tanks 124
By Janet Novack
As many states' finances crumble, new market-oriented think tanks at the statehouse level are challenging the old vested interests.

Unforeseen Consequences 150
By James R. Norman
Privatizing the operation of some Navy ships was supposed to help the merchant marine. It wasn't supposed to enrich a union and its boss.

On The Docket:
Tenure 164
By James Lyons
Kings and federal judges have jobs for life. Want a similar deal?

MARKETING

Smarter Boob Tube? 159
By Joshua Levine
Can direct-response advertising raise the intellectual level of TV?

COMPUTERS/COMMUNICATIONS

Fidelity Versus Citicorp 38
By David Churbuck
Banking-law reform is irrelevant. It's a battle of computer technology.

Aldus Corp. 176
By Kathleen K. Wiegner
It counts on presentation software to jazz up its growth. Also: Commentary by Esther Dyson.

SCIENCE & TECHNOLOGY

Smart Glue 180
By Gary Slutsker
Understanding glia may lead to treatments for Alzheimer's. Also: Commentary by Michael Gianturco.

FACES BEHIND THE FIGURES

George Wackenhut 190
Wackenhut Corp.
M. Lee Pearce 190
Investor
Howard Silverman 190
Gruntal & Co.
William Hayden 191
Jaguar

PERSONAL AFFAIRS

Techie Heaven 184
By Andrew Tanzer
Why Tokyo's Akihabara district has become a prime tourist destination.

Collectors: Reproductions 186
By Christie Brown
Why hang the original?

Careers: Eager Pupils 188
By Dyan Machan
How do you deal with employees who can't do basic math or write?

COLUMNISTS

Observations 66
Thomas Sowell
Capital Markets 201
Ben Weberman
The Contrarian 202
David Dreman
Wall Street Irregular 204
Mark Hulbert
Business Strategy 205
Alan Reynolds

DEPARTMENTS

Side Lines 8
Follow-Through 10
The Informer 16
Readers Say 20
Fact and Comment 23
Other Comments 28
Commentary 33
What's Ahead For Business 35
Flashbacks 211
Thoughts 212

Editorial index is on page 6

Cover illustration by Patrick McDonnell

COMPANIES IN THIS ISSUE

Forbes

EACH REFERENCE IS TO THE FIRST PAGE OF THE STORY IN WHICH THE COMPANY NAME APPEARS.

A

A&P, 114
Acciones y Valores, 68
Advo-System, 78
Aetna Life and Casualty, 188
Ahold, 114
Airbus Industrie, 41
Alaska Airlines, 96
Alcoa, 202
Aldus, 176
All Nippon Airways, 41
Ethan Allen, 186
AmBase, 190
Amca International, 98
Amerada Hess, 127
America West, 48
American Agronomics, 142
American Electric Power, 56
American Express, 186
American Medical International, 190
AmeriFirst Bank, 190
Ames Department Stores, 144
Amgen, 182, 195
AMR, 41, 48, 195
Andersen Consulting, 178
Anderson Clayton, 68
Anglo American, 130
Apple Computer, 176, 178, 184
Archer Daniels Midland, 42
Arco Chemical, 42
Argus Investment Management, 195
Giorgio Armani, 64
Artagraph Reproduction Technology, 186
Athena Neurosciences, 180
Atlantic Richfield, 42

B

Baltimore Gas & Electric, 208
Bank of Japan, 78
Bankers Trust, 113
Barrington Research Associates, 98
Bay Tankers, 150
Michael Baybak, 174
BBC/Bristol, 159
Berkshire Hathaway, 142
Best Products, 144
Blinder, Robinson, 174
BMW, 191
Boeing, 41, 48
Borland International, 178
Hugo Boss, 64
Braniff, 48
Bristol-Myers Squibb, 171, 209
British Airways, 41
British Gas, 208
Brunswick, 199
Business Latin America, 205
H.E. Butt Grocery, 164

C

California bonds, 120
Caltex, 56
Cambridge Associates, 159
Campbell Soup, 114
Campeau, 16
Cargill, 42
Carolina Power & Light, 208
Carter-Wallace, 209
Caterpillar, 98
CenCor, 208
Centex, 93
Centocor, 78, 182
Central & South West, 198
Cephalon, 180
Chanel (Pamerco), 64
Charter Medical, 10
Chase Brass & Copper, 98
Chemical Banking, 16, 113
Chiba Prefecture, 16
Chock Full o' Nuts, 142
Christian Dior (Warnaco), 64
Chrysler, 48
Cigatam, 68
Cincinnati Milacron, 98
Cisco Systems, 195
Citicorp, 38, 56, 113
Clairol (Bristol-Myers Squibb), 144
Cleveland Cliffs, 78
Clorox, 114, 199
CNBC, 24
CNN (Turner Broadcasting System), 174
Coca-Cola, 10, 42, 114, 199
Collective Bancorp, 78
Combustion Engineering, 98
Commodore International, 20
Compaq Computer, 178
ConAgra, 114
Conair, 144
Cone Mills, 211
Continental Airlines Holdings, 48
Corning, 56
Corrections Corp of America, 190
Cott, 114
Counsellors Tandem, 198
Crain's Detroit Business, 142
Cray Research, 178
Cross & Trecker, 98

D

Daimler-Benz, 78
Dallas Cowboys, 16
Dannon (General Biscuit), 114
Dataquest, 176
Theo. H. Davies, 56
DDB Needham Worldwide, 114
De Beers, 130
Dean Witter (Sears, Roebuck), 201, 208
Edward J. DeBartolo, 16
Delhaize, 114
Dell Computer, 195
Delphi Financial Group, 78
Delta Air Lines, 41, 48, 195
H.A. DeNunzio, 186
Detroit Edison, 208
Deutsche Bank, 78
Digital Equipment, 38
Dillon, Read (Travelers), 208
Discover Channel, 159
Walt Disney, 16
Dominick & Dominick, 10
Donaldson, Lufkin & Jenrette (Equitable Life Assurance), 44
Dow Chemical, 56
Dow Theory Letters, 204
DRI Computer Leasing (Volt Information Sciences), 178
Du Pont, 68

E

Eastern Air Lines (Continental Airlines Holdings), 48
Eastman Kodak, 66, 176
Eaton, 35
ECI Telecom, 195
Ecos International, 171
Eczacibasi, 171
Empresas Gamesa, 10
Enka, 171
Escada Group, 64
Executive Telecard, 10
Eximbank, 171
Exxon, 23, 56

F

Federal Express, 23
Federal Home Loan Mortgage, 201, 202
Fed Nat'l Mortgage Assn, 202
Fidelity funds (FMR), 78, 201
Fidelity Investments (FMR), 38
Financière Agache, 74
First Financial Fund, 78
First Financial Holdings, 78
First National Supermarkets, 114
First RepublicBank, 16
Florida Progress, 208
Food Lion, 114
Ford Motor, 23, 48, 191
France Télécom, 68
Franklin Resources, 38
Freeport McMoRan, 198
Frisco, 68
Fujitsu, 184

G

Galas de México, 68
GE, 41, 56, 198, 201
Gencor, 130
Genentech, 202
General Foods, 114
General Mills, 114
General Motors, 48, 66, 211
Genesco, 174
GFV Communications, 142
Giant Food, 114
Giddings & Lewis, 98
Gillette, 114, 144
Gimbel's, 178
Charles J. Givens Organization, 174
Gliatech, 180
Goldman, Sachs, 10
Government National Mortgage Association, 38, 201
Grant's Interest Rate Observer, 78
Grow Group, 114
Grupo Carso, 68
Grupo Escorpion, 10
GTE, 68
Guinness, 74
Gulfstream Aerospace, 23

H

Hach, 188
Hannaford Bros., 114
Harcourt Brace Jovanovich, 56
H.J. Heinz, 114
Helen of Troy, 144
Heritage House Galleries, 186
Hershey Foods, 114
Hibernia, 10
Hills Department Stores, 144
Hirose, 184
Hitachi, 184
Holiday, 171
Home Depot, 78
Honda Motor, 88
Houston Industries, 198
Hovnanian Enterprises, 93
Hughes Tool, 23
Hulbert Financial Digest, 204
Hussman Econometrics, 204

I

IBM, 35, 38, 56, 176, 178, 184
Infiniti, 191
Ingersoll-Rand, 98
Inland Steel, 98
International Business Services, 171
International Marine Carriers, 150
Interstate/Johnson Lane, 209
Ito Yokado, 78

J

Jaguar fund, 78
James River, 195
Johnson & Johnson, 78
Joop!, 64
Joshin Denki, 78

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JVC, 184

K
Kaufman & Broad, 93
Keisei Electric Railway, 16
Kellogg, 114, 199
Keystone funds, 38
Kidder, Peabody (GE), 78
Kimberly-Clark, 114
Kinder-Care Learning Centers, 10, 208
KKR, 114
KL, 64
Kobe Steel, 166
Koc Group, 171
Kroger, 114

L
La Petite Academy, 208
Christian Lacroix (LVMH), 64
Ladenburg, Thalmann, 208
Landmark funds, 38
Rena Lange, 64
Laox, 184
Laredo National Bank, 23
Lennar, 93
Levi Strauss, 211
Lexus, 191
LG&E Energy, 208
Lipper Analytical Services, 120
Little Caesar Enterprises, 142
Loblaw, 114
Lord Abbett funds, 199
Lotus Development, 176
LVMH Moët Hennessy Louis Vuitton, 74

M
R.H. Macy, 178, 184
I. Magnin (R.H. Macy), 64
Major Realty, 142
Malt-O-Meal, 114
Market Logic, 204
Marketing Intelligence Service, 114
Markston Investment Management, 199
MCA (Sony), 142
McDonald's, 44
McGraw-Hill, 56, 159
Merck, 198
Merrill Lynch, 196, 208
Metropolitan Life, 211
MGM-Pathe Communications, 16
Micrografx, 176
Microsoft, 38, 176, 178
Mikimoto, 88
Minneapolis Star & Tribune, 176
Minnesota bonds, 120
Mitsubishi Bank, 88
Mitsui Real Estate, 16
Mobil, 56
Mondi, 64
Morgan Stanley, 78
Morrison & Foerster, 184
Motorola, 188
MPT Review, 195
MSO, 150
Municipal Assistance, 120
Mutual Benefit Fund, 199
Mutual Benefit Life Insurance, 199
Mutual Fund Values, 120

N
Nacional de Dulces, 68
National Presto Industries, 199
Neiman Marcus (General Cinema), 64
New York Graphic Society (Chartwell Group), 186
New York Times, 174
Newsweek, 114
Nintendo, 78
Nishikawamusen, 184
Nissan Motor, 48
Novell, 178
Novellus Systems, 78

O
Occidental Petroleum, 208
Omni Capital Group, 78
Omron, 184
Orange-co, 142
Oriental Land, 16

P
Pacific Gas & Electric, 208
PaineWebber, 98
Pan Am, 48
Pawtucket Red Sox, 186
J.C. Penney, 56
PepsiCo, 10, 114
Pfizer, 171
PHH, 202
Philadelphia Electric, 198
Philip Morris, 68, 114
Phillips Petroleum, 56
PHM, 93
Placer Dome, 68
Planned Television Arts, 174
Playboy, 68
Polaroid, 202
Pratt & Whitney, 41, 98
T. Rowe Price, 201
Procter & Gamble, 114 144, 171, 201
Proler International, 78
Prudential Insurance, 114
Pullman Memorial Hospital, 20
Puma fund, 78

Q
Qantas, 41
Quaker Oats, 114
Quark, 176
Quarterdeck, 178

R
Ralston Purina, 114
Research Systems, 114
RJR Nabisco, 114
Rolls-Royce, 41
Ryland Group, 93

S
Safeway Stores, 8, 114
J. Sainsbury, 8, 114
Saks Fifth Avenue (Investcorp), 64
Salomon, 17, 48, 93, 113, 186
Sanborn, 68
Jil Sander, 64
Santa Fe Pacific, 56
Sara Lee, 114
Sato Musen, 184
SCEcorp, 208
Charles Schwab, 38
Scientific American, 180
Scudder funds, 38
Sea Mobility, 150
Sealed Air, 78
Seatrain Lines, 150
Segumex, 68
Sequa, 78
ServiceMaster, 202
Sharp Electronics, 184
Sharper Image, 186
Shaw's, 114
Shearson Lehman Brothers Holdings, 93, 201
Simon & Schuster, 174
Smith Barney (Primerica), 127
Smith's Food & Drug Centers, 78
Smithfield Foods, 195
Snecma, 41
Snell Associates, 114
Software Publishing, 176
Sony, 88, 184
Southwest Airlines, 8, 48
Southwest Securities, 144
Southwestern Bell, 68
Stanhome, 199
Klaus Steilmann, 64
Stoneridge Resources, 142
Stratus Computer, 38
Sun Microsystems, 38
Supermarket Business, 114
Supermarket Strategic Alert, 114

T
T-Zone, 184
Tambrands, 114
Tasaki Pearl, 88
Tate & Lyle, 42
Telefónica de España, 23, 68
Teléfonos de México, 68, 78
Temco, 186
Tengelmann, 114
Texaco, 56
Texas International, 48
Texas Utilities, 208
Tiffany, 88
Tiger Fund, 78
Time Warner, 16, 159
Time, 114
Times (London), 74
Alfred C. Toepfer International, 42
Toll Brothers, 93
Toshiba, 184
Toto, 184
Toyota Motor, 23, 48
Transco Energy, 127
Triboro Bridge & Tunnel Authority bonds, 120
Trout & Ries, 114
Trygg-Hansa, 190
TVS Entertainment, 16
TW Real Estate, 10

U
U.S. Home, 93
U.S. Trust, 120
UAL, 41, 48, 164, 195
UDC-Universal Development, 93
Unilever, 68
Union Pacific, 56
United Technologies, 190
United Telecom, 23
Universal Health Services, 78
Upjohn, 171
USAir Group, 48
USX, 166
USX-Marathon Group, 166
USX-U.S. Steel Group, 166
UtiliCorp United, 208

V
Value Line, 114
Van Cleef & Arpels, 88
Vencor, 195
Visa, 38
Volkswagen, 23
Vons, 114

W
Wackenhut, 190
Wal-Mart Stores, 56, 78, 195
Walgreen, 68
Wall Street Journal, 96, 174, 208
E.M. Warburg, Pincus, 198
Warner-Lambert, 209
Washington State bonds, 120
Wegmans, 114
Wells Fargo, 16
Wendy's International, 142
Weyerhaeuser, 211
Williamette Industries, 195
Wisconsin bonds, 120
WSGP Partners, 20
WTD Industries, 78

X
Xerox, 202
Xoma, 182

Y
Yamagiwa, 184
YPF, 23

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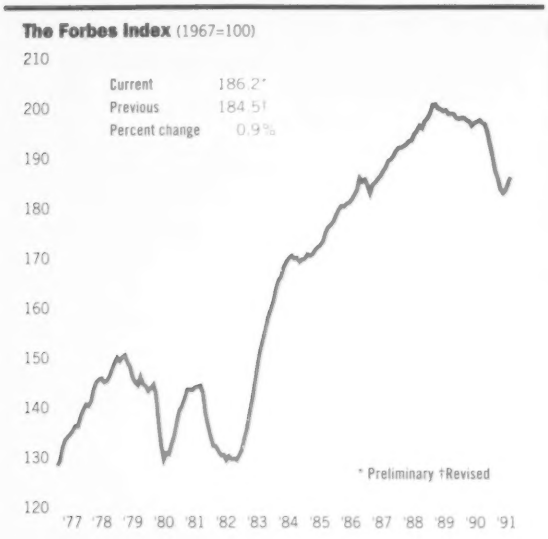
THE FORBES INDEX

BY TIMOTHY DODMAN



The Forbes Index shows a preliminary increase of 0.9% for July, following June's 0.5% gain. Good, but not great, as economic recoveries go. During the six months following the two previous recessions, the index averaged monthly gains of 1.5%. From its April 1991 low, however, the Forbes Index's average monthly gain has been 0.6%. One of the economic bright spots is manufacturing. Orders for durable goods jumped 10.7% in July. New housing starts rose 2.1% from June to July. But that leaves them 5% below their July 1990 level.

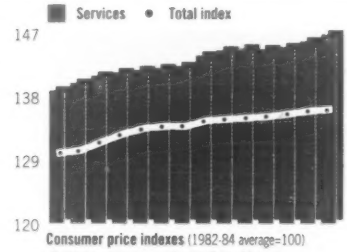
Other key rates	Source	Status
Prime rate	Chase Manhattan Bank	8.5%
Auto sales year to date vs 1990[1]	Ward's Automotive	-11.0%
Index of leading indicators June vs May	Dept of Commerce	0.5%
Trade balance 12 months ended June 1991	Dept of Commerce	-$84 bil
All-commodity producer price index July vs June[2]	Dept of Labor	-0.3%
GNP 2nd quarter vs. 1st—annualized growth	Dept of Commerce	0.4%
M2 (3-month change)—annualized growth[3]	Federal Reserve	1.9%

[1] U.S.-based manufacturers, excludes imports, as of 8/20/91. [2] Wholesale goods. [3] Includes M1 (public currency and checking deposits) plus savings accounts and money market funds.

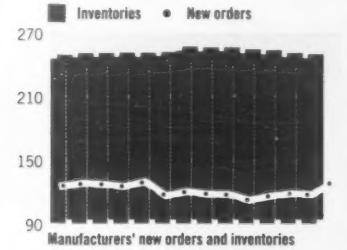
Index components

The Forbes Index is a measure of U.S. economic activity composed of 8 equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, new housing starts, total retail sales, the level of new orders for durable goods compared with manufacturers' inventories, personal income, total consumer installment credit.

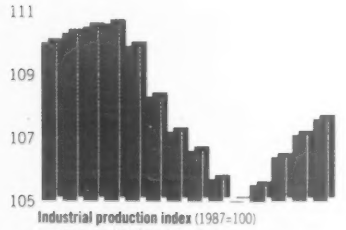
To measure these 8 elements, FORBES monitors 10 series of U.S. government data. The last 14 months' data for each series are presented below.



Consumer price indexes (1982-84 average=100) all urban consumers, unadjusted (Dept of Labor)

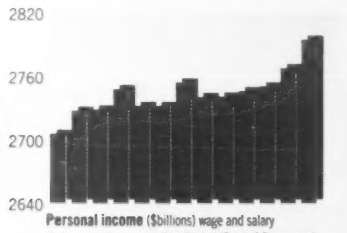


Manufacturers' new orders and inventories ($billions), seasonally adjusted (Dept of Commerce)



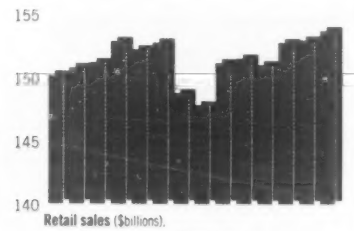
Industrial production index (1987=100) seasonally adjusted (Federal Reserve)

New housing starts (thousands) privately owned, unadjusted (Dept of Commerce)

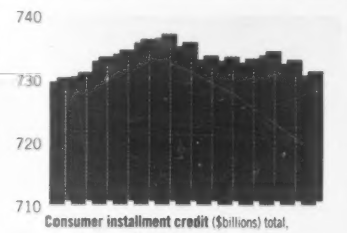


Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept of Commerce)

New unemployment claims average for month (thousands), seasonally adjusted (Dept of Labor)



Retail sales ($billions), seasonally adjusted (Dept of Commerce)



Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)

J J A S O N D J F M A M J J J J A S O N D J F M A M J J J J A S O N D J F M A M J J

THE FORBES/BARRA WALL STREET REVIEW

BY ERIC S. HARDY

By traditional Graham and Dodd measures, the stock market is overvalued: Companies are trading at 2.3 times their book value and 33 times their dividend payments. Nonetheless, Louis Navellier, a money manager and publisher of the *MPT Review* newsletter, sees plenty of buys. The 75 companies on his computer-generated recommended list show expanding profit margins and recent positive earnings revisions from analysts. The high number of stocks on his buy list is only one reason Navellier is optimistic about the market, at least in the short term. He's also impressed by the diversity of the list, which includes computer companies like Dell and Cisco Systems, pork producer Smithfield Foods, and ECI Telecom, an Israeli phone equipment maker traded here via ADRs.

Like Navellier, A.C. Moore, who follows the market for Argus Investment Management, agrees that stocks overall look pretty expensive. But Moore believes the big surge in growth stocks so far this year has distorted traditional valuation measures. "Growth stocks [like Wal-Mart and Amgen] are up so much this year that the whole market's P/E and price/book ratio is overstated," he argues.

Moore thinks the market looks strong and could get stronger based on other factors, including favorable technical action such as breadth (the number of advancing stocks relative to declining ones) and the ratio of new highs to new lows. He also sees low interest rates that appear to be headed even lower as especially favorable. A value investor, Moore is recommending mostly stocks trading at below-market multiples of book value and earnings. Cyclical stocks look cheap to him, and paper is among his favorite industries. "I can buy stocks like James River and Willamette Industries at close to book value," he says, "while the overall market is trading at about 2½ times book." Moore also likes big airlines—UAL, Delta, and especially AMR.

The overall market

Closeup on the market

Index or investment	2-week change	% change from 1 year	% change from 5-year high
Barra All-US index	0.7%	26.2%	0.0%
Sharpe/Barra Growth index[1]	1.1	34.7	0.0
Sharpe/Barra Value index[2]	0.1	12.9	-0.3
Dow Jones industrials	-0.2	21.1	-1.0
S&P 500	0.5	27.4	0.0
NYSE	0.5	26.9	0.0
Nasdaq	1.7	43.9	0.0
Amex	0.4	16.5	-1.0
EAFE[3]	0.2	4.1	-22.7
CRB index[4,5]	-0.4	-14.1	-23.0
Gold[5]	-1.0	-13.9	-29.4
Yen[5]	0.2	-6.6	-16.7
Oil[5]	1.5	-31.4	-46.7

The best and worst performing stocks[6]

Best	Price	2-week change	1991 EPS[7]	Worst	Price	2-week change	1991 EPS[7]
Security Pacific	35¼	49%	$2.60	Coventry	9½	-47%	$1.41
Boulevard Bancorp	18	41	0.07	Salomon	22⅝	-38	4.60
System Software	20½	37	0.91	Eljer Industries	7½	-30	0.45
Immune Response	17	33	-0.33	MacNeal-Schwendler	11½	-26	1.11
Midlantic	8	33	-2.56	Lifeline Systems	10¾	-26	0.65

The best and worst performing industry factors[6,8]

Best	2-week change	Since 12/31/90	Worst	2-week change	Since 12/31/90
Banks	5.3%	47.7%	Real estate	-5.7%	23.6%
Life insurance	4.1	15.4	Precious metals	-5.3	-19.4
Photographic, optical	3.0	-6.4	Motor Vehicles	-5.1	16.2
Coal, uranium	2.8	-6.8	Air Transport	-3.3	12.6
Agriculture, food	2.7	26.6	Water transport	-2.3	22.3

Note: Data for period ending 8/22/91. The Barra All-US index consists of all publicly traded common stocks for which price quotations are available and ordinary shares of foreign stocks trading on U.S. markets. ADRs, REITs and closed-end funds are excluded. [1] Total return of a portfolio of more than 150 large-capitalization stocks that has high historical earnings growth and has predicted above-average earnings growth. [2] Total return of a portfolio of more than 300 large-capitalization stocks characterized by low price-to-book ratios, high yields and low price-to-earnings ratios. [3] A dollar-denominated capitalization-weighted index of more than 1,000 stocks from Europe, Australia, New Zealand and the Far East. Source: Morgan Stanley Capital International Perspective. [4] Index of 21 commodity futures. [5] Knight-Ridder Financial Information. [6] During the last two weeks. [7] Estimate. Source: Institutional Brokers Estimate System, from Lynch, Jones & Ryan. [8] Shows return to the industry factor after controlling for other influences including company size, value and growth characteristics. Multi-industry firms have proportional contributions in two or more groups. NM: Not meaningful. Principal source: Barra, Inc., Berkeley, Calif.

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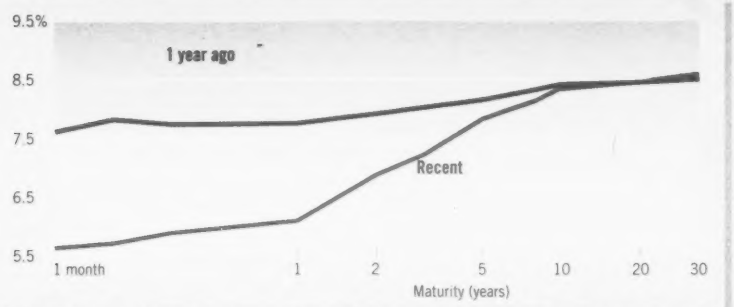
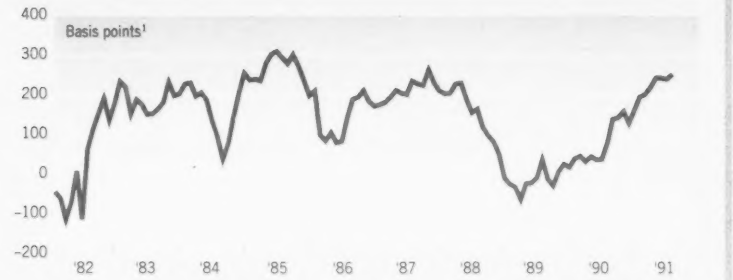
FIXED INCOME REVIEW

BY ERIC S. HARDY

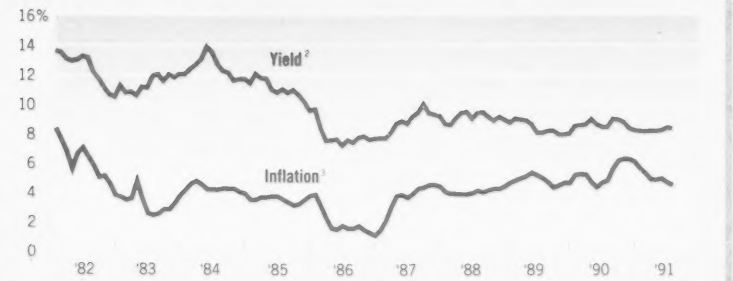
Yield curve



30-year rate minus 1-year rate



Yield vs. inflation



Spread over Treasurys

Security	Basis points[1]
AA corporates	50
AAA industrials	55
Ginnie Maes	66
Junk corporates[4]	723
Municipals[5]	-158

Total returns

Security	1 year[6]	3 years[6,7]
AAA corporates	10.6%	10.8%
Ginnie Maes[5]	11.8	11.9
Junk corporates[4]	15.9	8.6
Municipals[5]	8.7	9.3
Treasury bonds	9.9	10.4

Administration and congressional predictions of record-high federal budget deficits have failed to stem the rather dramatic price gains in Treasury bonds, whose long-term yields have dropped in less than a month's time to 8% from 8.5%. Rates on three-month T bills have fallen to less than 5.4% (equivalent to 5.5% on a bond that pays interest semiannually).

The rally in risk-free U.S. Treasurys also pushed up prices, and therefore pushed down yields, on corporate and municipal issues. But not as much as you would expect. Since early August, says David Madigan, municipal strategies manager at Merrill Lynch, "we've seen long-term municipal bond yields decline only slightly—about 10 or 15 basis points [10 or 15 hundredths of a percent]—while Treasury rates have fallen sharply. This has created one of the best buying opportunities in municipals in several years." Madigan is not too concerned about the creditworthiness of municipals, even in states like New York and Massachusetts, but concedes that an investor who buys expecting easy capital gains might be disappointed. He thus advocates a "buy and hold" in which the investor sweats out the credit scares.

Short-term nongovernment securities (such as commercial paper, bankers' acceptances and repurchase agreements) all yield well below 6%, which helps explain the historically low yields of money market funds. But credit quality remains poor. Moody's Investors Service reports that ratings downgrades are still outnumbering upgrades for corporate bonds of all maturities. During the second quarter the ratio of downgrades to upgrades for corporate debt was more than 3-to-1. Investment-grade bonds fared the best, what with 62 of the 96 downgraded issues being junk bonds.

The "real" yield on Treasury bonds—the gross yield minus an allowance for inflation—is running at around 4%, much lower than it was in the early 1980s *(see Yield vs. inflation chart)*, but not too bad when you figure in today's much lower tax rates.

Note: Except where footnoted, all information provided by Berkeley, Calif.-based Barra, a financial consulting firm. [1]A basis point is equal to one-hundredth of a percentage point. [2]Yield on ten-year Treasurys. [3]The trailing 12-month increase in the Consumer Price Index, through 7/31/91. [4]Source: First Boston. [5]Source: Shearson Lehman Brothers. [6]Data through 7/31/91. [7]Annualized

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